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No. 1722

In the Supreme Court of the United States

OCTOBER TERM, 1970

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the United States may recover the value of Treasury checks paid upon the forged endorsements of the payee from a presenting bank, where government employees were responsible for the forgeries.

STATUTE AND REGULATIONS INVOLVED

Section 3–405 of the Uniform Commercial Code provides in part:

> (1) An indorsement by any person in the name of a named payee is effective if
>
> * * * * *
>
> (c) an agent or employee of the maker or drawer has supplied him with the name of the payee intending the latter to have no such interest [in the instrument].

Title 31, Part 360 of the Code of Federal Regulations provides in part:

> § 360.4 Guaranty of indorsements.
>
> The presenting bank and the indorsers of a check presented to the Treasurer for payment are deemed to guarantee to the Treasurer that all prior indorsements are genuine, whether or not an express guaranty is placed on the check. When the first indorsement has been made by the one other than the payee personally, the presenting bank and the indorsers are deemed to guarantee to the Treasurer, in addition to other warranties, that the person who so indorsed had unqualified capacity and authority to indorse the check in behalf of the payee.

§ 360.5 Reclamation of amounts of paid checks.

The Treasurer shall have the right to demand refund from the presenting bank of the amount of a paid check if after payment the check is found to bear a forged or unauthorized indorsement or an indorsement by another for a deceased payee where the right to the proceeds of such check terminated upon the death of the payee, or to contain any other material defect or alteration which was not discovered upon first examination. If refund is not made, the Treasurer shall take such action against the proper parties as may be necessary to protect the interests of the United States.

STATEMENT

The United States sued the Bank of America National Trust and Savings Association for breach of a contract of guaranteee and to recover money paid by mistake. The district court held for the government on the basis of *National Metropolitan Bank* v. *United States,* 323 U.S. 454, which is factually identical, and because of paramount considerations of federal policy (Pet. App. viii–xvi).[1] The court of appeals unanimously affirmed on the ground that *Metropolitan* was dispositive.

The relevant facts were stipulated. At the pertinent times in 1965 and 1966, Sherrett and Reed were enlisted men working in a Navy disbursing office. Early in 1966, they obtained the identification card of one Spiller, who had been discharged from the Navy on

[1] The district court also entered judgment for the Bank on its uncontested third-party complaint against Sherrett and Reed, the culpable government employees (Pet. 6).

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OPINIONS BELOW

The opinion of the United States District Court for the Northern District of California (Pet. App. iv–xvi) is reported at 288 F. Supp. 343. The opinion of the United States Court of Appeals for the Ninth Circuit (Pet. App. i–iii) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on February 22, 1971. The petition for a writ of certiorari was filed on May 19, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

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January 1, 1966. Sherrett substituted his picture for that of Spiller. Reed made up pay records, pay receipts and check records in Spiller's name, and typed unsigned Treasury checks payable to Spiller. They then presented these documents to the disbursing officer. The latter, having no knowledge of any wrongdoing and no reason to suspect it, signed six checks, totaling $6,672 over a six-week period. Each check was returned to Sherrett or Reed for delivery to Spiller.

Sherrett took the checks to various branches of the Bank. In each instance, he signed Spiller's name and showed the altered identification. The Bank cashed each of the checks, believing him to be Spiller. The record does not indicate whether other identification was rquested and the signature was not verified.

The Bank indorsed each of the checks with an express guaranty of prior indorsements and presented them to the Treasury through the appropriate Federal Reserve Bank. Each was paid without knowledge on the part of the Treasury of the unauthorized signatures. Shortly thereafter, the forgeries were discovered. Sherrett and Reed were arrested and subsequently convicted.[2]

ARGUMENT

Petitioner concedes that this case is factually similar to *National Metropolitan Bank* v. *United States*, 323 U.S. 454, but argues (Pet. 7–10) that *Metropolitan* is no longer viable because the decision there was

[2] Some reimbursement was made by Reed, thus reducing the government's claim.

based upon the then-prevailing principle of commercial law favoring the drawer of the check while commercial law now favors the bank (Uniform Commercial Code, Section 3–405). Contrary to petitioner's contention, however, *Metropolitan* rested not only upon general commercial law, but also on federal policy considerations which are still valid today. The decision below is, in any event, of limited significance in view of the adoption, effective in October 1967, of a Treasury regulation explicitly making the drawee bank responsible in instances of forged indorsements. (31 C.F.R. 360.5). Review by this Court is therefore not warranted.

1. *Metropolitan* also involved the government's attempt to obtain reimbursement for payments to a bank which had, in good faith, presented checks which had been forged by military personnel. The Court, sustaining the government's claim, expressly rejected the bank's argument that the loss should fall on the government since it was caused by "negligence of the government's administrative officers in detecting the fraud of its clerk * * *." 323 U.S. at 456. The Court stated that this defense had been rejected in *United States* v. *National Exchange Bank,* 214 U.S. 302, where the Court had been "applying the general law merchant * * *." 323 U.S. at 457. It concluded that "[n]o persuasive reasons have been suggested to us why it should not be accepted as the general federal rule." *Ibid.* The Court in *Metropolitan* pointed out that most state courts had accepted the rule urged by the government, although it noted *Washington Loan & Trust Co.* v. *United States,* 134 F. 2d 59 (C.A. D.C.),

which had discussed the practice of several states to the contrary. *Ibid.*

The Court did not, however, rest its opinion solely on the prevailing state law. It stressed Treasury regulations which require a blanket and absolute guarantee of prior endorsements and discussed their purpose. 323 U.S. at 458 (emphasis added):

> This guaranty [set out in the regulation] was a protection which the government sought not only as to checks which were issued in due course for a valuable consideration, but as to checks which might have been irregularly issued. That the administrative officers failed fully to perform their duty is no reason why the government should be deprived of the advantage of a guarantee *independently made by one who was not under compulsion of any kind to make it.* No equitable principles require that one who, *for his own reasons,* guarantees a payee's signature after issuance of a check, shall be relieved of his *voluntarily assumed obligation* because others who owed the government obligations had previously defaulted in their obligations.

The regulation (now 31 C.F.R. 360.4) is still in existence. Indeed, the Treasury Department, as we note below, pp. 9–10, promulgated another regulation (31 C.F.R. 360.5) subsequent to *Metropolitan* expressly codifying the decision in that case.[3]

[3] While the new regulation does not apply to the particular transactions involved here, it does represent a clear statement of the continuing federal policy concerning the government's rights to be protected by a presenting bank's guaranty of prior indorsements and to recover when that guaranty is broken.

The considerations of the policy which the *Metropolitan* decision reflects are still pertinent today. Comparing the respective positions of banks and the government, then as now, reveals cogent reasons for placing the risk of payment of forged checks upon banks, even though commercial law now generally places that burden upon business employers.

Banks have an opportunity to guard against paying such checks. As a practical matter, most persons seeking to endorse a forged check will be persons who are not customers or otherwise known to the bank. In these cases, the bank can minimize its risks by requiring thorough verification of signature or additional identification from such strangers. As a last resort, the bank can simply refuse to cash a check presented by a stranger.

The United States, on the other hand, is not a typical business employer. The government is not a profit-making enterprise, nor is it "normally in a better position to prevent * * * forgeries" by selecting better employees. U.C.C. § 3–405, comment 4. We are informed by the Treasury Department that in fiscal year 1968 approximately 574,000,000 checks were drawn on the Treasury of the United States. See also Annual Report of the Secretary of the Treasury, 1968, p. 89. This is twice the number drawn yearly at the time of the decision in *Metropolitan*. Brief for the United States, No. 161, Oct. Term, 1944, p. 21. Many thousands of persons take part in the preparation and disbursement of these government checks. Many are not hired for the purpose of disbursing government funds,

but are Armed Forces personnel serving short terms in government "employment," as were Sherrett and Reed here. The costs of bonding all employees or of making more extensive character investigations would be significant. And those costs would be charges on the public treasury, borne by the taxpayers, rather than a cost of doing business, borne ultimately by stockholders.

Uniquely federal interests thus justify the retention of the federal rule, regardless of the change in state law.[4] In *Clearfield Trust* v. *United States,* 318 U.S. 363, the Court recognized that "[t]he rights and duties of the United States on commercial paper which it issues are governed by federal rather than local law," and that Treasury regulations covered almost every aspect of its negotiability. 318 U.S. at 366 & n. 2. The same is true today. See 31 C.F.R. Part 360; 5 U.S.C. 301; see also 18 U.S.C. 286, 287, 471. And federal statutes and case law protect the Treasury in many other areas where state law would give precedence to other parties. *E.g.,* 31 U.S.C. 191–192 (government debts to be first satisfied in insolvency situations); *United States* v. *City of New Britain,* 347 U.S. 81, 85.

2. Petitioner does not contend that the decision below, in continuing to follow *Metropolitan,* directly conflicts with that of any other circuit. Indeed, the

[4] Although thirty-eight states had adopted the rule urged by the Bank as of 1963, this Court still reaffirmed the proposition that "federal law applies * * * in a choice of substantive law * * * in cases involving rights and obligations arising on commercial paper issued by the United States," citing the *Metropolitan* decision. *International Assn. of Machinists* v. *Central Airlines, Inc.*, 372 U.S. 682, 693, n. 17.

Fifth Circuit applied *Metropolitan* in 1957, by which time seventeen states had adopted a rule favoring the bank. *Atlantic National Bank of Jacksonville* v. *United States,* 250 F. 2d 114 (C.A. 5). Petitioner does argue, however (Pet. 10–11), that the decision below is essentially inconsistent with decisions of several federal courts which have refused to extend the *Metropolitan* rule to the "imposter" situation involving fictitious payees. See *United States* v. *Bank of America National Trust and Savings Association,* 274 F. 2d 366 (C.A. 9); *Atlantic National Bank of Jacksonville* v. *United States, supra.* The alleged inconsistency is of no consequence in this context, for the courts below correctly applied the *Metropolitan* rule to forgers here. Whether that rule also should be applied to impostor situations is, of course, not presented in this case.

3. The prospective importance of the decision below has been considerably reduced by the promulgation of a new Treasury regulation. All the checks in question here were paid in 1966 (Pet. App. xvii). In October 1967, a Treasury regulation was adopted expressly codifying the holding in *Metropolitan:*

> § 360.5 Reclamation of amounts of paid checks.
>
> The Treasurer shall have the right to demand refund from the presenting bank of the amount of a paid check if after payment the check is found to bear a forged or unauthorized indorsement * * *. If refund is not made, the Treasurer shall take such action against the proper parties as may be necessary to protect the interests of the United States.

In our view, this regulation will control and dispose of virtually all future cases of a forged and unauthorized indorsement. Cf. *United States* v. *Shimer*, 367 U.S. 374, 377.

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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